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C O N F I D E N T I A L SECTION 01 OF 02 BAGHDAD 002537

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TAGS: ECON ETRD EFIN PGOV IZ
SUBJECT: PRIVATE INVESTMENT IN REFINERIES - OPPORTUNITIES AND CHALLENGES

REF: A. BAGHDAD 2443
¶B. BAGHDAD 770

Classified By: Economic Minister Charles Ries for reasons 1.4 (b) and (d).

¶1. (SBU) Summary: The Council of Representatives (CoR) passed the Private Sector Investment in Oil Refineries law on July 24. As is part of the Iraqi process, this law requires approval from the Presidency Council and then publication in the Official Gazette in order to become law. This law is separate from the four-part hydrocarbon legislative package (the framework Hydrocarbon law, the Revenue-Sharing law, the Iraq National Oil Company law, and the reorganization of the Ministry of Oil law). Nonetheless, it is an important indication that the Iraqi government is able to pass necessary reforms in the oil sector while balancing the demands of the central and regional governments.

¶2. (SBU) In line with the Investment Law approved by the CoR in October 2006 and published in the Official Gazette on January 17, which specifically did not cover the oil and gas sector, this law provides opportunities for both domestic and foreign investors, with limited restrictions. As continues to be an issue of dispute in negotiations about the framework Hydrocarbon Law, the final negotiations resolved the relative rights and roles of the central and regional governments. In many ways this law legalizes what has already begun in the Kurdistan Region. If passed by the Presidency Council, as is likely, the next challenge will be to develop and distribute useful implementing regulations. End summary.

Basic Provisions of the Law

¶3. (U) The first article of the Private Sector Investment in Oil Refineries law explains the legislation's purpose as "to encourage the private sector to participate in the economic development process and to contribute to building the oil industry by participating in refining crude oil." The law actively encourages both foreign and domestic investment. It stipulates that the Ministry of Oil would provide oil for such investments at prices set at 1% less than international rates, and that investors are responsible for much of the necessary infrastructure, particularly extra pipelines and electricity generation. Investors will be able to use storage facilities, ports, and Iraqi pipelines for export as determined in their contracts with the Iraqi government. The law requires that Heavy Fuel Oil (HFO) production in new refineries not exceed 20%. Iraq now has simple, single-stage refineries which produce HFO at a rate of 50%. USG expert advisors have encouraged the Ministry of Oil to move towards better technology, arguing that any new project should include a cracking unit, bringing the rate of HFO production to 20% or lower. The most sophisticated refineries produce almost no HFO.

¶4. (U) In general, the law tracks with the level of openness found in the Investment Law published in the Official Gazette in January (ref B) - both foreign and domestic private sector investment is encouraged, with the most significant restrictions relating to land ownership and an Iraqi workforce. The Refineries Law allows for 40-year renewable leases, compared to the Investment Law's 50-year renewable leases. The other major restriction relates to Iraqi employees; the Refineries Law requires that 75% of a project's employees be Iraqi. Similar language was proposed for the Investment Law, but resulted in just a 'priority for Iraqi workers' rather than a numerical requirement. Projects also benefit from incentives allowed for investments within free trade zones in Iraq.

Perspective from the KRG

¶5. (C) This law legalizes activity already on-going in the Kurdistan Region. The KRG has licensed small oil companies to build refineries. As with the framework Hydrocarbon Law, the Kurds carefully negotiated the provisions related to the relative powers of the regions and the central government. In the approved Refineries Law, regions and provinces have the right to participate in the ministerial-level committee on investment in oil refineries when the proposed projects fall within their borders. Regions and provinces also have the right to grant licenses "in coordination with" this ministerial committee. During the final stages of negotiations on July 23, CoR Oil and Gas Committee Chair Ali Belu told EMin that the final point of disagreement was whether to use the phrase "in coordination with" or "with the agreement of" the ministerial committee (ref A). In general,

we have heard positive feedback from our contacts about this law, and the CoR's approval shows that the GOI was successfully able to balance the demands of both the central and regional authorities.

Implementation

¶6. (C) Minister of Oil Hussayn al Shahristani told EMin on July 25 that he thought many companies would be interested in investing in refineries in Iraq; so far he has only been contacted by Nippon Oil. The company wanted to invest in a refinery near Nassiriya, with the stipulation that it also would have exploration rights. Minister Shahristani said that linking projects would not be allowed, even after the new hydrocarbon legislative package is in place. Nonetheless, he said that when oil fields are open to bidders for development, the company could indicate that it also wanted to build a refinery in its bid.

¶7. (C) Other MinOil officials have expressed skepticism to Emboffs about the implementation plans for the law. Events over the past year indicate that this step is as difficult, if not more so, than passing the initial law. The Fuel Import Liberalization Law, passed by the CoR last fall, still does not have implementing regulations sufficiently rigorous to attract international investment, although it has served as a basis for the issuance of 12 import licenses to companies in the KRG. The GOI also has been slow to implement the Investment Law, which awaits the formation of a National Investment Commission. Implementation is likely to be further complicated by the security situation, increasing the costs of investing the large amounts required for a modern refinery. Still, this law is an important step forward in modernizing the oil sector, and ending centralized control over this major Iraqi industry. Minister Shahristani told the UPI news service on July 26 that the GOI plans to maintain the government-owned and operated refineries until the private sector can meet market demand. "As the private

sector takes over this activity," Shahristani said, "the government will be stepping down."

Comment

¶8. (C) Comment: Compared to the negotiations on the four-part hydrocarbon legislative package the Private Sector Investment in Oil Refineries Law sailed through both the Council of Ministers and the Council of Representatives. One reason is that it is a much less complicated law dealing with a specific area within the oil sector; another is that the refining of oil products may simply be less controversial an issue for Iraqis than the ownership of the rights to crude oil. Also, Iraq continues to suffer from a severe shortage of refined oil products, a shortage felt on a daily basis by most Iraqis, and this law speaks directly to resolving that shortage. Language saying as much is included in the law's 'explanatory note'. This law has also had much less outside attention, allowing for lower-profile negotiations without intense scrutiny and criticism from the media. Many Iraqis continue to believe that U.S. policy is driven by the demand for oil, and our attention to the four-part hydrocarbon legislation can be misunderstood as further evidence of this underlying motive for our activities in Iraq.

¶9. (C) This law is reasonably sound and should succeed at promoting private sector investment in what has been under the complete purview of a centralized government. The law resonates with other investment related legislation approved over the past year, with clear, though cautious, steps towards a free market economy. While the challenge of implementation remains, this law also shows that the Iraqi government is able to balance the demands of the central and regional authorities while developing the legal framework needed for modernizing the oil sector.
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